"And, the Law Applicable to the Arbitration Agreement Is…"

By Erika Sondahl Levin

Introduction

Parties employ international arbitration for a number of reasons, including efficiency, neutrality, enhanced control over the process, the expertise of the arbitrators, and the enforceability of the award. However, these advantages may be severely compromised if an arbitration clause is poorly drafted and the parties subsequently become embroiled in a lengthy and costly legal battle over an issue that relates to the existence, validity, effect, construction, or discharge of the agreement to arbitrate.[1] Importantly, "whether the arbitration agreement is valid or not, under the law applicable to it, will have a bearing on whether the dispute can be referred to arbitration, whether court proceedings can be halted, and whether the resulting award is enforceable."[2]

"In a system that prides itself on promoting efficiency and predictability for its users, the lack of consensus over how to resolve the question of which law governs an arbitration agreement contained within a highly complex international contract undoubtedly warrants consideration."

As a creature of contract, the arbitration agreement forms the necessary entryway into arbitration by providing the requisite consent of the parties to final adjudication by an arbitral tribunal.[3] Although parties generally designate a choice of law clause (the substantive law governing the main contract) and a seat of arbitration (the procedural law of the arbitration), they typically do not specify the law that will govern the arbitration agreement.[4] While it was often thought that this level of specificity was not necessary,[5] recent developments indicate otherwise. Indeed, it has become quite clear that there is simply no international consensus on how to resolve questions relating to which law should govern the arbitration agreement in the absence of a clear designation by the parties. In light of the increasing complexity of matters governed by international arbitration, these concerns are especially pronounced when multiple jurisdictions are involved, (*e.g.*, Country X is chosen as the seat of arbitration and the law of Country Y is chosen as the governing law of the main contract). In such situations, parties should consider whether a conflict may arise with respect to the laws of Country X and Country Y in relation to the interpretation of their arbitration agreement and attempt to resolve any ambiguity at the drafting phase by specifically designating the law that they intend to govern their arbitration clause.

The risk of failing to clearly designate the law applicable to the arbitration agreement in an international transaction is especially apparent when dealing with actions to compel arbitrations and actions to enforce awards. Parties to contracts with multiple laws at play may find themselves engaged in a proverbial tug of war between various laws. For instance, in defending against an action to compel arbitration, a party might rely on Article II(3) of the New York Convention and argue that the agreement to arbitrate is "null and void, inoperative, or incapable of being performed."[6] Similarly, in defending against an action to enforce an arbitral award, a party might rely on Article V(1)(a) of the New York Convention and assert that the agreement in question is "not valid under the law to which the parties have subjected it or, failing any indication thereon, under the law of the country where the award was made."[7] Without a specific designation, it is unclear which law the court will rely on to resolve such questions. More likely than not, one party will advocate for the application of the substantive law of the main contract, while the other party will object to that reasoning on the basis of the separability presumption and/or the New York Convention and contend that the arbitration clause should be governed by the law of the seat of the arbitration.

These are just a few examples of the many ways in which this issue might arise in practice, and parties and their attorneys need to be mindful of these risks when drafting their arbitration clauses. Parties may attempt to address questions regarding the interpretation of their arbitration agreement and attempt to resolve any ambiguity at the drafting phase by specifically designating the law that they intend to govern their arbitration clause. Admittedly, the drafting of an arbitration clause is neither done in a vacuum nor with the aid of a crystal ball. Thus, parties and their counsel will have to strike an appropriate balance in order to preserve the deal as well as their efficient recourse to arbitration in the event that a dispute does arise.

Striving for Consensus

In a system that prides itself on promoting efficiency and predictability for its users, the lack of consensus over how to resolve the question of which law governs an arbitration agreement contained within a highly complex international contract undoubtedly warrants consider-

ation. Commentators have posited that as many as nine different approaches exist to resolve the choice of law analysis relating to the arbitration agreement.[8] Without a clear designation by the parties, uncertainty abounds as no single approach has been adopted by courts, arbitrators, or commentators.

An "[a]nalysis of the choice of the law governing an international arbitration agreement begins with the separability [or severability] presumption."[9] Essentially, this doctrine distinguishes the arbitration agreement from the main underlying contract and provides that the arbitration agreement "can stand on its own validity even if the underlying contract falls away."[10] In other words, this doctrine contemplates two separate and distinct agreements contained within a single contract. As a result, when multiple laws are involved, the separability presumption may be relied upon to support the application of one law to the main contract and another law to the arbitration agreement.[11]

Consistent with this approach, Articles II and V of the New York Convention have been interpreted to "rest on the premise that the international arbitration agreement is a separable contract, subject to a specialized and *sui generis* international legal regime, not applicable to other contracts."[12] Although Article II of the [New York] Convention does not expressly prescribe a choice-of-law rule, "[it] set[s] forth substantive international rules of presumptive substantive validity, directly applicable to (and only to) international arbitration agreements…[and] prescribe[s] specialized international rules of formal validity, also applicable only to international arbitration agreements."[13] Article V(1)(a) of the New York Convention provides that "[r]ecognition and enforcement of the award may be refused…[if] the said agreement is not valid under the law to which the parties have subjected it or, failing any indication thereon, under the law of the country where the award was made."[14]

According to Gary Born, "Article V(1)(a) of the New York Convention contemplates that the parties may select a particular law to govern only their arbitration agreement ('the law to which the parties have subjected it') and establishes a specialized choice-of-law rule providing that, where the parties have not explicitly or implicitly selected a law to govern their arbitration clause, that provision will be governed by 'the law of the country where the award was made [presumably the law of the seat].'"[15] Moreover, the presumptive validity of an arbitration agreement, enshrined within Article II(3) of the New York Convention, may also be relied upon in order to prevent the application of parochial rules that might somehow circumvent or invalidate the parties' arbitration agreement.[16]

Support has also emerged for the application of a validation principle that embraces the pro-arbitration objectives of the New York Convention.[17] "[T]his principle gives effect to the parties' overriding intention that their international arbitration agreement will be valid and effective, regardless of the jurisdictional and choice-of-law complexities that attend other international contracts."[18]

Recent Decisions

Over the last few years, courts in various jurisdictions have grappled with this issue. Of the recent decisions, the most well-known is that of *Sulamérica v. Enesa*, which involved an insurance dispute between Sulamérica, the insurer, and Enesa Engenharia, the insured, over claims related to the construction of the Jirau Greenfield Hydro Project, a hydroelectric generating plant in Brazil.[19] When the insured made claims under the policies, the insurer responded by filing an arbitration proceeding in London and sought a declaration of non-liability.[20] The insured, on the other hand, filed an action in Brazilian court.[21] The insurer subsequently sought an injunction from the English Commercial Court in order to restrain the insured from proceeding with its action in Brazilian court. The English Commercial Court granted the injunction to the insurer, and the insured appealed. The insurance policies at issue provided for arbitration in London under ARIAS Arbitration Rules, contained a choice of Brazilian law as the substantive law, and a clause which subjected "[a]ny disputes arising under, out of or in connection with this Policy … to the exclusive jurisdiction of the courts of Brazil."[22]

The English High Court was tasked with determining which law should govern the arbitration clause. It started its analysis with the rebuttable presumption that the parties' express choice of the substantive law of the main contract was also intended to govern the arbitration agreement:

> It has long been recognised that in principle the proper law of an arbitration agreement which itself forms part of a substantive contract may differ from that of the contract as a whole, but it is probably fair to start from the assumption that, in the absence of any indication to the contrary, the parties intended the whole of their relationship to be governed by the same system of law. It is common for parties to make an express choice of law to govern their contract, but unusual for them to make an express choice of the law to govern any arbitration agreement contained within it; and where they have not done so, the natural inference is that they intended the proper law chosen to govern the substantive contract also to govern the agreement to arbitrate.[23]

However, noting that English courts have also held that the designation of an arbitral seat can be an important indicator that the parties intended a different law to govern

their arbitration agreement,[24] the *Sulamérica* court applied a three-part test seeking to evaluate whether: (1) an express designation as to the law governing the arbitration agreement had been made; (2) an implied choice existed; or (3) in the absence of any choice, which law would have the closest and most real connection to the arbitration agreement.[25] Having found that neither an express nor an implied choice had been made by the parties,[26] the court ultimately held that the law possessing the closest and most real connection with the arbitration agreement was the law of the seat since this is where the "supporting and supervisory jurisdiction necessary to ensure that the procedure is effective" would take place.[27]

What is curious about *Sulamérica* is that it involved Brazilian parties, a dispute that arose in Brazil, a substantive choice of Brazilian law as the governing law of the main contract, and conflicting clauses, one of which provided for arbitration in London under ARIAS Arbitration Rules,[28] and another which provided for the exclusive jurisdiction of the courts of Brazil.[29] Nonetheless, the Court through the application of its three-part test found that English Law was the law with closest and most real connection to the dispute and should thus govern the issues pertaining to the arbitration agreement.

While this may seem odd at first, a closer analysis reveals that the Court may have been "motivated by a desire to uphold the validity of the arbitration agreement and to 'save' the arbitration agreement from the law governing the underlying contract which threatened its existence."[30] "[B]y applying the law of the seat, [the *Sulamérica* Court] saved the arbitration agreement from the purported rule under Brazilian law that the arbitration agreement could only be invoked with the insurer's consent."[31] Interestingly, "in all the prior cases in which the English courts held that the law of the seat was applicable to the arbitration agreement rather than the law of the underlying contract, the courts avoided the purported invalidity that would have affected the arbitration agreement at the behest of the law governing the underlying contract."[32] The justification for such a pro-arbitration or validation approach is that it preserves the parties' intentions and objectives to arbitrate.

Although a thorough analysis of *Sulamérica* and its progeny including *Arsanovia*,[33] *Habas*,[34] and *FirstLink*[35] is beyond the scope of this article, it is useful to note that these cases have demonstrated that the *Sulamérica* test may not be as straightforward or as predictable as one would have initially hoped. This is especially true if one assesses consistency from the perspective of whether the law of the seat or the substantive law of the main contract is applied. *Firstlink* is particularly noteworthy in this regard because, although the High Court of Singapore adopted the three-part test as set forth in *Sulamérica*, it expressly rejected the English Court's rebuttable presumption that a choice of substantive law was also intended to govern the arbitration agreement.[36]

However, what if the *Sulamérica* test was not intended to be measured that way, but rather was meant to operate as a vehicle to enable adjudicators to embrace a pro-validation or pro-arbitration approach?[37] When viewed from this backdrop, the *Sulamérica* test not only provides guidance, but it affords adjudicators with the flexibility necessary to promote the consistent enforcement of arbitration agreements. Such an approach would comport with the pro-arbitration goals of the New York Convention and would promote consistency amongst all jurisdictions.[38]

Institutional Perspective

From the standpoint of the world's leading arbitral institutions, varying approaches exist to determine the law applicable to the arbitration agreement, ranging from pointing to the law of the seat as controlling,[39] to deferring to the arbitrators to either apply the law with the closest connection,[40] or to applying the law which the arbitrator finds most appropriate.[41]

It bears noting that the Hong Kong International Arbitration Centre ("HKIAC") has not only addressed this issue in its 2013 amendments to its Administered Arbitration Rules, but has also revised its model arbitration clause to now include a provision, which states that "[t]he law of this arbitration clause shall be…(Hong Kong law)."[42] Parties are advised by the HKIAC that the inclusion of this provision is optional, but "should be included particularly where the law of the substantive contract and the law of the seat are different."[43] To date, the HKIAC is the only institution to have provided for such a provision in its model arbitration clause.

Conclusion

Even though some decisions over the last few years have highlighted the problems that arise when parties omit an express designation of the law applicable to the arbitration agreement, the situation is not utterly hopeless. Parties can enjoy some modicum of comfort from the fact that adjudicators seized with this issue will often do their best to effectuate the parties' intent to arbitrate as memorialized in their arbitration agreement. Relying upon the New York Convention's pro-arbitration objectives, the focus seems to have shifted away from the tug of war over whether to apply the law of the seat or the governing law of the main contract. Instead, the courts seem to increasingly embrace a validation or pro-arbitration approach, in which the emphasis is on preserving and enforcing the parties' arbitration agreement. Even so, the court's involvement will certainly come at a significant cost. While the designation of a law applicable to the arbitration agreement may not be appropriate in every situation, at a minimum, a preliminary analysis should be undertaken at the drafting stage in an effort to understand the potential interplay between the various laws involved and to proactively manage any anticipated risks.

Endnotes

1. Peter Ashford, *The Law of the Arbitration Agreement: English Courts Decide?*, 24 Am. Rev. Int'l Arb. 496 (2013).
2. Sabrina Pearson, *Sulamérica v. Enesa: The Hidden Pro-Validation Approach Adopted by the English Courts with Respect to the Proper Law of the Arbitration Agreement*, 29 Arb. Int'l 115 (2013).
3. *See* N. Blackaby, C. Partasides, A. Redfern, & M. Hunter, Redfern and Hunter on International Arbitration (5th ed., Oxford University Press, 2009), 18-19, 84-85; Jeff Waincymer, Procedure and Evidence in International Arbitration (Kluwer Law International, 2012), 129; Paul D. Friedland, Arbitration Clauses For International Contracts (2d. ed., Juris Net, LLC, 2007) (citing *United States Steelworkers of Am. Mfg. Co.*, 363 U.S. 564, 569 (1960) ("arbitration is a creature of contract")), 58-59.
4. J. Lew, L. Mistelis, & S. Kroll, Comparative International Commercial Arbitration (Kluwer Law International, 2003), 120.
5. This is especially the case in situations when the law of the seat is the same as that designated by the choice-of-law clause since that same law will also govern the arbitration agreement. *See Karaha Bodas Co., LLC v. Perusahaan Pertambangan Minyak Dan Gas Bumi Negara*, 364 F.3d 274, 291 (5th Cir. 2004) ("[A]n agreement providing that one country will be the site of the arbitration but the proceedings will be held under the arbitration law of another country [is] 'exceptional'; 'almost unknown'; 'a purely academic invention'; 'almost never used in practice'; a possibility 'more theoretical than real'; and a 'once-in-a-blue-moon set of circumstances.'"). *Cf.*, Pierro Bernardini, *Arbitration Clauses: Achieving Effectiveness in the Law Applicable to the Arbitration Clause*, Improving the Efficiency of Arbitration Agreements and Awards: 40 Years of Application of the New York Convention, ICCA Congress Series, 1998 Paris Volume 9 (Kluwer, 1999), 197 (discouraging the inclusion of a law directly applicable to the arbitration agreement).
6. Convention on the Recognition and Enforcement of Foreign Arbitral Awards ("The New York Convention"), December 29, 1970, 21 U.S.T. 2517, 330 U.N.T.S. 3.
7. *Id*.
8. *See* Gary B. Born, International Commercial Arbitration (2d. ed., Kluwer Law International, 2014), 471-72 (describing the "multiplicity of choice-of-law rules…[as] ranging from the law chosen by the parties to govern their underlying contract, to the law of the arbitral seat, to the law of the judicial enforcement forum, to the law of the state with the 'closest connection' or 'most significant relationship.'"); Marc Blessing, *The Law Applicable to the Arbitration Clause and to Arbitrability*, Improving The Efficiency of Arbitration Agreements and Awards: 40 Years Of Application Of The New York Convention, ICCA Congress Series, 1998 Paris Volume 9 (Kluwer, 1999), 168-69 (identifying nine theories for determining the law applicable to the arbitration agreement; adding among others, the law of the place where the agreement was concluded, law of the parties, and an a-national approach).
9. Born, *supra* n. 8 at 472.
10. D. Lindsey & Y. Lahlou, *The Law Applicable to International Arbitration in New York,* J. Carter & J. Fellas, International Commercial Arbitration in New York (Oxford University Press, 2013), 15 ("The agreement to arbitrate is treated as an agreement that is separate from, although clearly related to, the underlying contract.").
11. Born, *supra* n. 8 at 472. A healthy dose of scholarly debate exists over how extensively the separability doctrine should be employed to resolve such questions, and whether separability was really only intended to operate as a savings mechanism to protect the parties' agreement to arbitrate should a problem arise with the underlying contract. Pierre Mayer, The Limits of Severability of the Arbitration Clause, Improving The Efficiency Of Arbitration Agreements And Awards: 40 Years of Application of The New York Convention, ICCA Congress Series, 1998 Paris Volume 9 (Kluwer, 1999), 263 ("[s]everability should thus be limited to those situations in which refusal to give effect to the clause, through a sort of solidarity with the rest of the agreement, would prevent arbitration of the issues that the parties intended to be resolved by the arbitration."). *But cf.*, Ashford, *supra* n. 1 at 471 (suggesting that such a limited interpretation is "so counter to modern orthodoxy on separability that it has little future").
12. Born, *supra* n. 8 at 477.
13. *Id.*
14. The New York Convention, *supra* n. 6. Although subtle distinctions exist, the law of the seat of the arbitration is usually treated synonymously with the law where the award was made/rendered. *See* A.J. van den Berg, The New York Arbitration Convention of 1958 (1981), 295. In the absence of a choice of law by the parties, Article V(1)(a) has been interpreted to support a default choice of law in favor of the law where the award was made. *See* Pierre Mayer, *supra* n. 11 at 266, n. 13 (stating that the situation is "somewhat less clear when the agreement contains a choice of law clause" yet noting that commentators like A.J. van den Berg have found "[i]n favour of applying the law of the place where the award was rendered even when the contract contains a choice of law clause" (internal citation omitted). *See also* Julian D. M. Lew, *The Law Applicable to the Form and Substance of the Arbitration Clause*, ICCA Congress Series No. 9, Improving the Efficiency of Arbitration Agreements and Awards: 40 Years of Application of the New York Convention (Kluwer, 1999) (advocating that Article V(1)(a) may be the key to determining the law applicable to the arbitration agreement), 144.
15. Born, *supra* n. 8 at 476.
16. *Id.*
17. *Id.* at 1318.
18. *Id.* at 493.
19. *Sulamerica v. Enesa Engenharia*, [2012] EWCA Civ 638.
20. *Id.*
21. *Id.*
22. *Id.*
23. *Id*.
24. *Id*. (citing *Black Clawson International Ltd. v Papierwerke Waldhof-Aschaffenburg AG* [1982] 2 Lloyd's Rep. 446 and *Sonatrach Petroleum Corp. v Ferrell International Ltd.* [2002] 1 All E.R. (Comm) 627).
25. *Id.*
26. *Id*. Both parties conceded that no express choice of law relevant to the arbitration agreement existed. The court held that no implied choice of law existed, although there were powerful indicators that could support such a conclusion, because (1) "the choice of another country as the seat of the arbitration inevitably imports an acceptance that the law of that country relating to the conduct and supervision of arbitrations will apply to the proceedings," and (2) "The possible existence of a rule of Brazilian law which would undermine that position tends to suggest that the parties did not intend the arbitration agreement to be governed by that system of law."
27. *Id.*
28. The reinsurers were not Brazilian.
29. *Id.*
30. A concern existed that if Brazilian law had been applied to the arbitration agreement, it would have invalidated the arbitration agreement. Pearson, *supra* n. 2 at 123-24. "Before the Court of Appeal, Enesa argued that it was not bound to arbitrate because the arbitration agreement was governed by the law of Brazil, pursuant to which the arbitration agreement could only be invoked with its consent." *Id.* at 115. Sulamérica relied on the

separability presumption and argued that the choice of London as the seat of the arbitration justified the decision that English law should govern the arbitration agreement. *Id.* at 121. "One of the key issues was therefore the determination of the law applicable to the arbitration agreement." *Id.* at 115. "[R]efus[ing] to endorse a bright line rule of law according to which the proper law of the arbitration agreement would always be the law of the place of the seat… "the Court provided guidance on determining the proper law applicable to the arbitration agreement" through its three-part test. *Id.* at 121.

31. *Id.* at 123.

32. *Id.*

33. *Arsanovia Ltd. and others v. Cruz City 1 Mauritius Holdings*, [2012] EWHC 3702 (Comm.) (holding that the expressly designated substantive law of the contract is a strong pointer to the parties' intentions regarding the law applicable to the arbitration agreement and may be an implied choice of law applicable to the arbitration agreement, and second that the selection of London as a seat is not itself an implied choice of English law for the arbitration agreement under the *Sulamerica* test, and concluding that had it been necessary to ascertain the law with the closest and most real connection to the arbitration agreement, this would have been the law of the seat).

34. *Habas Sinai Ve Tibbi Gazlar Istihsal Endustrisi AS v. VSC Steel Company, Ltd.* [2013] EWHC 4071 (Comm.) (holding that the choice of seat in conjunction with the terms of an arbitration agreement are a strong indication of the law applicable to the arbitration agreement and may constitute an implied choice of law under the *Sulamerica* three-prong test).

35. *FirstLink Investments Corp Ltd. v. GT Payment Pte Ltd.* and others, [2014] SGHCR 12 (applying Sulamerica's three-prong test and holding that it is "more commercially sensible" to presume that the parties implicitly chose the law of the seat as the law applicable to the arbitration agreement by virtue of designating it as the seat, and this is not undone by a choice of substantive law for the underlying contract).

36. *Id.* "[T]his court takes the view that it cannot always be assumed that commercial parties want the same system of law to govern their relationship of performing the substantive obligations under the contract, and the quite separate (and often unhappy) relationship of resolving disputes when problems arise. In fact, the more commercially sensible viewpoint would be that the latter relationship often only comes into play when the former relationship has already broken down irretrievably. There can therefore be no natural inference that commercial parties would want the same system of law to govern these two distinct relationships. The natural inference would instead be to the contrary."

37. Pearson, *supra*, n. 2 at 115-126; Born, *supra* n. 8 at 1395-98 (advocating the application of a "pro-arbitration interpretative rule regardless of the national law applicable to the parties' agreement to arbitrate").

38. *See* Born, *supra* n. 8 at 1398.

39. London Court of International Arbitration, Arbitration Rules (2014), Art. 16.4.

40. Swiss Rules of International Arbitration (2012), Art. 33.1; Hong Kong International Arbitration Centre Administered Arbitration Rules (2008—prior version), Art. 31.1.

41. Hong Kong International Arbitration Centre Administered Arbitration Rules (2013—most recent version), Art. 35.1; International Chamber of Commerce Rules, Art. 21.1; International Centre for Dispute Resolution International Arbitration Rules, Art. 31.1; International Institute for Conflict Prevention & Resolution ("CPR") Administered Arbitration Rules (2013), Rule 10.1; Vienna International Arbitral Centre Arbitration (2013), Art. 27.2; Kuala Lumpur Regional Centre for Arbitration Rules (2013), Art. 35.

42. Hong Kong International Arbitration Center Model Clause for Administered Arbitration under HKIAC Rules, available at: http://www.hkiac.org/en/arbitration/model-clauses#1.

43. *Id*.

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